

June 22, 1998

**CERTIFIED MAIL
RETURN RECEIPT REQUESTED**

Mr. R. J. Buraglio
Lockheed Martin Advanced
Environmental Systems, Inc.
1920 East 17th Street, Suite 103
Idaho Falls, ID 83404

LOCKHEED MARTIN IDAHO TECHNOLOGIES COMPANY (LMITCO) SUBCONTRACT
NO. C91-133136 - CURE NOTICE - GHL-013-98

Dear Mr. Buraglio:

The purpose of this letter is to notify Lockheed Martin Advanced Environmental Systems, Inc. (LMAES) that LMITCO has determined that conditions exist pertinent to performance of Subcontract No. C91-133136 which necessitate issuance of a cure notice. Facts leading to this determination are as follows.

Summary:

In 1994, based on a proposal that emphasized its expertise, experience and the robustness of its technology, Lockheed Environmental Systems and Technologies Company (LESAT), predecessor to LMAES, was awarded a fixed price subcontract for approximately \$179 million to remediate Pit 9 at the Idaho National Engineering and Environmental Laboratory (INEEL). By the terms of the subcontract, LESAT agreed to excavate, characterize and treat the wastes in Pit 9 in LESAT-owned facilities that it would design, construct and operate.

During the initial two years of performance, LESAT exhibited significant technical and overall performance shortcomings which culminated in its failure to meet the required date of August 15, 1996, for initiation of the Limited Production Test (LPT). Based on LMAES's assurances that it would apply a new dedication to its performance, LMITCO issued LMAES a letter of forbearance with regard to the missed delivery date.

Seven months later, in March 1997, LMAES submitted a request for equitable adjustment (REA), setting forth a demand that LMITCO (and the U.S. Department of Energy (DOE)) pay LMAES an additional \$127.8 million for work done through March 1997, provide interim funding of some \$10 million per month and convert the subcontract from a fixed price commitment to a full cost reimbursement arrangement for future performance.

LMITCO rejected LMAES's request for interim funding and subcontract restructuring, which request would have had LMITCO (and DOE) assume all the technical and economic risks that LMAES had consciously agreed to bear in its subcontract. LMITCO did commit that the REA would be properly evaluated on its merits. LMITCO also issued a modification to the subcontract which provided a 27 month time extension based on the schedule provided by LMAES in connection with its REA.

In late May 1997, LMAES announced that it intended to suspend ordering equipment and to direct its subcontractors to reduce the pace of subcontract work and begin the steps necessary to terminate employees, effective the end of August 1997. Since that announcement, LMAES has implemented these actions while simultaneously assuring LMITCO that it intended to perform its subcontract obligations. To justify its failure to proceed, LMAES most recently has emphasized that it lacks certain technical direction necessary to permit it to proceed with performance. In response to LMAES's requests for technical direction, LMITCO has twice provided a thorough analysis of the technical issues raised by LMAES, pointing out that, contrary to LMAES's assertion that it lacks the technical direction necessary to proceed, such direction can be found in either a subcontract document or in LMAES's Best and Final Offer (BAFO). Thus, LMAES's repeated requests for technical direction are better understood as attempts to revise the subcontract terms to its advantage rather than reflecting confusion regarding subcontract requirements.

LMITCO considers LMAES's slowdown of subcontract work, release of employees, termination/slowdown of subcontracts and refusal to resume full performance of the subcontract to be conditions that endanger performance of the subcontract and may well be considered a repudiation by LMAES of its subcontract obligations.

Background:

On October 18, 1994, LESAT, entered into a subcontract with Lockheed Idaho Technologies Company (LITCO), predecessor to LMITCO, to perform the Pit 9 Comprehensive Demonstration Project. Pit 9 was one of the locations used for disposal of radioactive and hazardous chemicals waste at the INEEL. The INEEL is a DOE facility. LMITCO is the Management and Operating Contractor of the INEEL for the DOE.

In return for payment of \$178,608,000, subject to contractually provided adjustments, LMAES is obligated under the subcontract to design, install, and operate a facility and excavate, characterize, and treat as necessary certain radioactive waste and soil contained in the pit. After remediation of the pit, the subcontract requires LMAES to decontaminate and decommission (D&D) the entire facility. The subcontract is performance based rather than design based, *i.e.*, no design for the retrieval or treatment processes or structure(s) is provided. Instead, the subcontract contains a listing of performance standards and regulatory requirements that LMAES is required to meet as well as a schedule for five firm delivery dates. The design and construction of the remediation process and structure(s) are to be determined by LMAES, subject to applicable regulatory requirements.

Although the subcontract was actually signed in 1994, the Pit 9 project resulted from a lengthy process during which LESAT and its predecessor corporation, AWC Lockheed, were both fully involved. The record reveals that the final subcontract for the Pit 9 project was the result of "give and take" between EG&G Idaho, Inc. (LITCO's predecessor) and AWC-Lockheed/LESAT.

The draft Request for Proposal (RFP) was issued by EG&G Idaho on July 29, 1991. It was sent to 35 different private firms who had expressed interest by responding to Commerce Business Daily advertisements. On August 12, 1991, a pre-proposal conference was held which AWC Lockheed attended.

On November 19, 1991, a final RFP was issued to 18 firms. The clearly stated purpose of the RFP was to obtain retrieval and treatment services from a private sector firm under a subcontract that was both fixed price and performance based. Per the RFP, the subcontract was to be structured to include Phase I - Proof of Process (POP) tests; Phase II - design and construction of the facilities, and Phase III - full remediation of the pit and D&D of the entire facility. Another pre-proposal conference was held on December 4, 1991, and the date for submission of proposals was extended to January 20, 1992.

On January 20, 1992, EG&G Idaho received proposals from three offerors, including AWC Lockheed. After review by a Source Evaluation Board (SEB), one proposal was declared outside the technical competitive range. The remaining competitors, including AWC Lockheed, were required to make oral presentations in February 1992.

The SEB carefully considered the proposals, but had questions as to whether the technologies being proposed would work "as advertised." Accordingly, and once again as a result of discussions with AWC Lockheed and the other proposer, it was decided that EG&G Idaho would pay both proposers to perform POP tests (Phase I). The purpose of the tests was for the

proposers to demonstrate to EG&G Idaho that their respective processes would in fact operate as advertised. Subcontracts for performance of the POP tests were issued to each offeror in November, 1992. AWC Lockheed was paid approximately \$8,000,000 to perform these tests.

EG&G Idaho began receiving draft test plans in December 1992 and testing and reporting was completed by December 1993. EG&G Idaho, on December 6, 1993, issued a Request for Pricing Proposal (RFPP) for Phases II and III. In order to maintain project schedule, on November 23, 1993, each subcontractor was issued a change order to its respective POP test subcontract, to commence 30% design of its systems and develop a draft Preliminary Safety Analysis Report (PSAR). LESAT was paid an additional sum of approximately \$3.4 million for this effort.

In April 1994, both subcontractors submitted technical and pricing proposals as well as 30% design and draft PSAR documents. Starting in April 1994, EG&G Idaho initiated discussions with LESAT regarding its technical proposal and the requirements of the specifications. Once again, the record reflects comprehensive discussions of the technical aspects of LESAT's proposal. LESAT had full and ample opportunity to question any aspect of the RFPP or the proposed subcontract requirements that LESAT felt may have been unclear or in any manner ambiguous. As a result of these discussions, several of the proposed subcontract documents were revised.

On June 21 and 27, 1994, various revised subcontract documents, including the "Specification for Pit 9 Comprehensive Demonstration," were issued. As a result of these revised documents, an extension of time (to July 12, 1994) to respond to the call for BAFOs was granted.

LESAT submitted its BAFO on July 12, 1994. The BAFO incorporated a detailed technical proposal which provided a description of both the retrieval and remediation processes LESAT intended to provide, as well as the structures to house both. LESAT's BAFO represented a full and complete understanding of the technical requirements as well as a commitment to perform the requirements of the subcontract. Detailed schematic process and block flow diagrams were included, together with graphic representations of the retrieval and treatment facilities with proposed equipment layouts. (Both were based in large part on the 30% design which LESAT had been previously paid to perform.) Indeed, LESAT's BAFO proclaimed not only the "robust" nature of the proposed process, but also its ability to exceed the performance requirements of the subcontract, *e.g.*, its ability to exceed the 90% volume reduction requirement for material undergoing treatment.

Based upon the representations made in LESAT's BAFO, on August 26, 1994, EG&G Idaho issued a letter subcontract to LESAT for the performance of the Pit 9 Comprehensive Demonstration Project. LESAT commenced field work (topographic survey) on September 13, 1994. On October 18, 1994, a definitive subcontract was signed by LITCO and LESAT. The subcontract provided a day-for-day plus an additional 11 day extension to the BAFO schedule proposed by LESAT in July 1994.

The purpose of this background is to emphasize a fundamental point: that in actuality the decision to award the subcontract for the performance of the Pit 9 Comprehensive Demonstration Project was the result of a collaborative process during which EG&G Idaho relied on LESAT's statements as to the capabilities of the processes which LESAT proposed to utilize. Each subcontractor was paid approximately \$11,400,000 to demonstrate elements of its processes prior to award of Phases II and III as well as to produce a 30% design and draft PSAR. Any assertion that LESAT was in some manner misled into the subcontract, or that EG&G Idaho or DOE possessed "superior knowledge" is not supported by the facts. In fact, it was EG&G Idaho that was relying on LESAT's statements as to the capabilities of the proposed technologies in its decision to proceed with the subcontract for remediation.

Discussion:

Unfortunately, performance of the subcontract has not been in accord with statements in LESAT's BAFO, nor the subcontract. Please note the following:

- In October 1994, LESAT submitted a draft Systems Requirements Document (SRD). LITCO provided comments in December 1994, but LMAES did not resubmit the SRD until January 1997. (Please note that on June 28, 1996, LESAT merged with and into LMAES.)
- In November 1994 (less than a month after signing the definitive subcontract), LESAT announced at a meeting in Seattle that it planned on eliminating the counter current ion exchange unit from the chemical treatment system.
- In February 1995, LESAT submitted a draft PSAR that could not be approved by DOE due to the incomplete nature of the document.
- In June 1995, LESAT was originally scheduled to have the chemical treatment system test bed construction and checkout completed. This milestone remains to be accomplished.

- In July 1995, LITCO became aware of a significant deviation from LESAT's plasma melter test bed approach. Initially, LESAT proposed to complete the plasma melter test bed design and construction by this date and initiate testing to validate the design and train operations and maintenance personnel. As it turned out, LESAT decided not to construct a plasma melter test bed, even though this increased technical and schedule risk.
- In September 1995, LESAT presented an informal schedule indicating a slip of 2 to 3 months in start of the LPT, a subcontract delivery date. This was confirmed formally by LESAT in October 1995.
- In November 1995, at a design review meeting in Pocatello, LESAT noted a 4.5 month overall schedule slippage.
- In March 1996, LESAT advised there would likely be a schedule slippage of approximately 10 months. LESAT declined to commit to a new schedule.
- In April 1996, LESAT identified significant concerns with the chemical treatment system through review of designs and as a result of testing. LESAT informed LITCO that a chemical treatment system would not be installed and this operational step would be replaced by a soil sorting system.
- In May 1996, LESAT convened a "Peer Review Committee" to analyze the status of the proposed chemical treatment system as well as alternative approaches. The committee was highly critical of the ability of the chemical treatment system to function as designed.
- In June 1996, LESAT announced at another design review meeting its intention to abandon the chemical treatment system and replace it with a soil sorter system. The reasons given for abandonment of the chemical treatment system were large cost overruns, technical engineering problems, operational safety concerns, schedule delays, input materials variability, and the fact that LESAT's designer (Merrick) had not properly taken into consideration the maintenance and operability problems arising from the fact that the system was to be operated in a radioactively contaminated environment.
- In July 1996, LMITCO expressed concerns about the ability of the soil sorter system to meet the contractual requirements for volume reduction.

- In August 1996, LMITCO, based on LMAES's assertions of a new dedication to subcontract performance, issued a letter of forbearance with regard to the August 15, 1996, subcontract start date for LPT. At the same time LMITCO demanded that LMAES submit a new schedule and plan for subcontract performance.
- In October 1996, LMAES submitted a "Path Forward" proposing the deletion of the chemical treatment system and substitution of a soil sorter system. LMAES admitted that the soil sorter system would not achieve the 90% volume reduction requirement of the subcontract and stated that issue remained to be resolved.

It should also be noted that, since the execution of this subcontract, until approximately October 1996, LMAES experienced significant turnover in key personnel. For example, LMAES had a total of four different Project Managers and eight different Contract Manager/Administrators. Certainly, this type of turnover was inefficient and had a negative influence on LMAES's ability to effectively manage the project.

From October 1996 through March 1997, LMITCO, together with DOE and the Agencies (Environmental Protection Agency and the State of Idaho-Department of Environmental Quality), worked diligently with LMAES to enable it to define an acceptable Path Forward. The record reflects numerous meetings and conversations regarding LMAES's proposed process. However, on March 28, 1997, LMAES submitted a document entitled "Request for Equitable Adjustment." In this document LMAES demanded that LMITCO (and DOE) agree to pay it \$127,800,000 for costs incurred through March 31, 1997, provide interim funding of \$10,100,000 per month and convert the completion of the subcontract to a cost-type (as opposed to a fixed price) arrangement. LMAES also submitted a schedule which indicated that time to completion would be increased by 24 months (later extended to 27 months). Rather than providing any cost analysis, LMAES stated that it had priced the REA on a "modified total cost" basis, essentially placing all of the responsibility for LMAES's alleged cost overruns (with the exception of approximately \$8,000,000 for the cost of seismic upgrades, scheduling costs, and increased G&A) on LMITCO and DOE.

Meetings were held in April and May, 1997, to discuss various aspects of LMAES's REA. LMITCO issued Modification No. 20 to the subcontract on May 7, 1997, to establish a new schedule for performance of the subcontract which was based on schedule information provided by LMAES in connection with the REA. The revised schedule extended the time for start of LPT to August 21, 1998, over two years after the originally scheduled start of LPT.

LMITCO, on May 14, 1997, rejected LMAES's request for interim funding and subcontract restructuring. LMITCO indicated that the REA would be properly evaluated on its merits, but LMITCO was skeptical of the factual and legal basis for LMAES's claims as well as the basis for LMAES's modified total cost pricing. Nevertheless, the Defense Contract Audit Agency (DCAA) was asked by LMITCO to review LMAES's cost and pricing records to determine if there was a sufficient basis for LMAES's REA claim.

LMAES's response to the actions taken by LMITCO on May 14, 1997, rejecting interim funding and subcontract restructuring, were inconsistent with the subcontract terms and conditions. Although the subcontract changes and disputes clauses required it to proceed, LMAES announced that it would suspend ordering critical equipment, would direct its subcontractors to slow down, and would proceed to issue Worker Adjustment and Retraining Act Notices to employees informing them of layoffs, to be effective the end of August 1997. These actions severely impacted the design and construction of several of LMAES's major sub-systems such as the melter, soil sorter, and chemical treatment.

In an attempt to justify its actions, on June 5, 1997, LMAES issued a letter which set forth sixteen (16) "technical issues" for which LMAES asserted it needed direction before it could continue with subcontract performance. Ironically, the majority of these issues had been identified by LMITCO in a February 24, 1997, letter to LMAES as issues requiring resolution. The February 24, 1997, letter was a good faith attempt to establish a framework for reconciling these contractual issues and to assure that LMAES would be able to fulfill its obligations with respect to design and safety requirements.

LMAES's June 5, 1997, letter specifically referenced its May 22, 1997 letter to LMITCO. The May letter conditioned LMAES's willingness to proceed fully with subcontract performance on both cost relief and technical direction. The June 5, 1997, letter set forth LMAES's "interpretation of the subcontract requirements" for sixteen technical issues and stated that if LMITCO did not agree, LMITCO should issue a formal change order to the subcontract. The two letters taken together show that LMAES conditioned its full subcontract performance on LMITCO/DOE agreeing with LMAES's interpretations or on the issuance of change orders. Imposing these conditions was contrary to the subcontract requirements. The subcontract requires LMAES to fully proceed with the work while seeking relief under applicable subcontract provisions, even if LMAES disagreed with LMITCO's interpretation.

Despite the inappropriate form of LMAES's request, LMITCO undertook a good faith analysis of each issue. LMITCO responded on July 10, 1997, and pointed out that for each technical issue the answer could be found either in LMAES's BAFO or specific subcontract provisions or DOE orders that were referenced.

Instead of accepting the proffered direction, on July 25, 1997, LMAES responded with a letter challenging the adequacy of the direction. It appeared that LMAES did in fact understand the technical direction which it had been provided but still did not proceed.

LMITCO once again undertook a comprehensive review of the issues to determine whether the earlier direction had been clear and correct. On August 26, 1997, LMITCO responded and advised LMAES that the direction previously given was adequate and also directed that LMAES resume full-scale operations. LMAES disputed this in its letters of August 29, September 15, and October 29, 1997. Consequently, LMITCO once again undertook a detailed analysis of the issues and provided another analysis (over 20 pages) to LMAES on November 26, 1997. This letter also concluded that previously provided technical direction had been adequate and further directed LMAES to return to work.

On February 6, 1998, LMITCO received a letter in which LMAES continued to challenge not only the adequacy of the direction, but now maintained that its proceeding with the subcontract required LMITCO's prior agreement to LMAES's technical baseline as well as an agreement on a subcontract pricing modification. Neither demand is consistent with the subcontract. If LMAES felt the technical direction given by LMITCO was a change to the subcontract, LMAES's recourse, pursuant to the changes and disputes clauses, was to proceed as directed while submitting a properly documented REA for any alleged changes. Unfortunately, it appears that LMAES is unwilling to accept the fact that there is no contractual basis that compels LMITCO to grant advance approval of design configuration, additional funding, and subcontract restructuring. These are the apparent reasons for the work cessation, not a lack of technical direction.

LMITCO's ability to properly analyze the March 28 REA continues to be hampered by the fact that LMAES has not provided answers to the questions presented by DCAA and LMITCO and source documents sought by LMITCO even though, pursuant to the subcontract, those documents are the Government's documents and are to be turned over to LMITCO on request. LMAES has not done as the subcontract requires. While continuing to maintain in writing that LMAES stands ready to perform, LMAES's actions (such as actually laying off almost all its employees in August 1997, and interrupting performance by its subcontractors and suppliers) have been and continue to be exactly contrary.

These and other examples of LMAES's intransigence have been discussed in numerous letters, meetings, and telephone conversations between LMITCO and LMAES personnel. Unfortunately, despite the fact that LMITCO has repeatedly directed LMAES to return to work, LMAES has never complied with this direction. Therefore, LMITCO has no alternative but to issue this cure notice.

R. J. Buraglio
February 27, 1998
GHL-013-98
Page 10

Cure Requirements:

LMAES's refusal to resume full performance unless LMITCO changes the technical direction given to LMAES, alters the subcontract pricing structure, provides interim funding, and institutes a new subcontract schedule are all preconditions to performance that are contrary to the provisions of the subcontract. Pursuant to subparagraph (a)(2) of Article 53 entitled "Termination for Default (Revised)" of Standard Terms and Conditions for Purchase Orders and Subcontracts and Article 6 entitled "Termination for Default-Damages for Delay-Time Extensions" of the Construction Subcontract General Conditions, LMAES is hereby notified that LMITCO considers LMAES's slowdown, release of employees, termination/slowdown of LMAES's subcontracts, and refusal to resume full performance of the subcontract, to be conditions that are endangering performance of the subcontract.

Therefore, unless these conditions are cured within 30 calendar days after receipt of this notice, by providing adequate assurances demonstrating how LMAES intends to fulfill its obligation to remediate Pit 9, LMITCO may terminate the subcontract for default. By adequate assurances it is meant a definitive plan (and demonstrable actions towards implementing that plan) for LMAES fulfilling its obligations under the subcontract.

Sincerely,

Gary H. Longhurst
Senior Subcontract Administrator

cc: D. P. Letendre, DOE-ID, MS 1221
J. F. Nagle, Oles Morrison and Rinker
F. G. Schwartz, DOE-ID, MS 1117
R. R. Throckmorton, DOE-ID, MS 1203

R. J. Buraglio
February 27, 1998
GHL-013-98
Page 11

bcc: S. O. Baldwin, MS 3402 (Project File)
C. N. Fitch, MS 3402
D. L. Savage, MS 3402
P. J. Simonds, MS 3521
S. J. Winston, MS 3898
ER ARDC Pit 9 Project File, MS 3922
G. H. Longhurst File (GHL-013-98)